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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,
Petitioners,

VS.

AMERICAN SAVINGS BANK,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF AMERICAN BANKERS ASSOCIATION, AMERICAN FINANCIAL SERVICES ASSOCIATION, AND CREDIT UNION NATIONAL ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF THE RESPONDENT

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INTEREST OF *AMICI CURIAE*

If the decision of the United States Court of Appeals for the Fifth Circuit below were to be reversed, it would have a significant impact on the mortgage lending practices of innumerable financial institutions throughout the United States. The three *amici* who have joined to submit this brief in support of

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[1] Letters indicating the consent of all parties to the filing of this brief have been filed with the Clerk.

dent American Savings Bank are all trade associations whose constituent memberships comprise a significant portion of those financial institutions.

The American Bankers Association ("ABA") is the principal national trade association of the commercial banking industry in the United States. It has members in each of the fifty states and the District of Columbia, and its membership includes banks of all sizes and types – national and state, money-center, regional and community banks, independent and bank holding company owned banks. ABA member banks hold over ninety percent of the assets of the banking industry in this country. The ABA frequently appears in litigation as a party or as amicus curiae in cases of widespread importance to the industry at large.

The American Financial Services Association ("AFSA") is the nation's largest trade association representing non-bank providers of consumer financial services. Organized in 1916, AFSA represents 367 companies operating 10,910 offices engaged in extending over $200 billion of consumer credit throughout the United States. These companies range from independently-owned consumer finance offices to the nation's largest financial services, retail and automobile companies. Retail and automobile credit is extended through thousands of stores and dealers. Consumer finance companies hold over $150 billion of consumer credit outstanding and $67 billion in second mortgage credit representing one quarter of all consumer credit outstanding in the United States. Accordingly, AFSA has a vital interest in consumer bankruptcy.

Credit Union National Association ("CUNA") is the principal national trade association for credit unions in the United States. CUNA's direct membership consists of fifty-two credit union leagues covering the fifty states, the District of Columbia, and Puerto Rico. In turn, just over 90 percent of the approximately

13,800 credit unions in the United States are affiliated with CUNA through membership in CUNA's member leagues.

SUMMARY OF ARGUMENT

The clear meaning of § 1322(b)(2) of Title 11 United States Code ("Bankruptcy Code") is that loans secured by no collateral except mortgages on a debtor's home cannot be modified in Chapter 13. The only relevant inquiry is whether the creditor's claim is secured only by a security interest in the debtor's principal residence. There is no other qualification: the protection is not limited to first mortgage loans; it is not limited to the amount of the allowed secured claim; it does not exclude liens that exceed the value of the collateral; and it is not limited to mortgages on homes without fixtures, carpet, or insurance.[2]

Sections 506(a) and 1322(b)(2) do not permit "lien splitting" or "lien stripping" of residential mortgages in Chapter 13 bankruptcy cases. Bankruptcy Code § 506(a) is not a lien modification ("cramdown") provision. Rather, § 506(a) bifurcates bankruptcy claims for certain purposes, such as determining the extent of an undersecured creditor's share of the distribution to unsecured creditors. Section 506(a) does not affect liens, which flow through bankruptcy unless modified pursuant to a confirmed plan in Chapter 11, 12, or 13. Section 1322(b)(2) allows cramdown in a Chapter 13 plan, but expressly excludes from this authority any lien on the debtor's principal residence. The rights of holders of claims secured solely by liens on the debtor's residence cannot be modified in a Chapter 13 plan. Under the plain meaning of § 1322(b)(2), such holders are entitled to full payment or to enforce their liens by foreclosure.

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[2] This is the suggestion in strained cases like *Sapos v. Provident Institution of Savings in the Town of Boston*, 967 F.2d 918 (3d Cir. 1992) and *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123 (3d Cir. 1990).

Dewsnup v. Timm, 502 U.S. ___, 112 S.Ct. 773 (1992), is the latest in a strong line of United States Supreme Court decisions that has explained the relationship between § 506(a) and the specific Bankruptcy Code cramdown provisions. The basic explanation in *Dewsnup*, regarding the fundamental structure of the Bankruptcy Code and its effect on liens as *in rem* interests unaffected by § 506(a), is dispositive and cannot simply be ignored in this case. In contrast, post-*Dewsnup* decisions by the United States Courts of Appeals for the Second, Third and Ninth Circuits have failed to confront the reasoning in *Dewsnup* and the role of that case in explaining the basic structure of the Bankruptcy Code with respect to the treatment of liens. As a result, these cases do not properly interpret the Bankruptcy Code and should be rejected. Clearly, there is no basis in the Bankruptcy Code or its legislative history for allowing use of § 506(a) as a cramdown provision to modify liens in a proceeding under any chapter of the Bankruptcy Code.

ARGUMENT

I. The Plain Meaning of Bankruptcy Code Section 1322(b)(2) Precludes Any Cramdown of Home Mortgage Loans in Chapter 13 Cases

A. *General Discussion*

The plain meaning of a statute, such as § 1322(b)(2), should be conclusive, except in the rare case in which the literal application of the statute would "produce a result demonstrably at odds with the intention of its drafters." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989) (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982)). Thus, the

plain meaning of § 1322(b)(2) prohibits modification of the "rights" of the "holder" of a "claim" secured solely by a debtor's residence. The term "claim" includes secured and unsecured claims.[3]

The United States Court of Appeals for the Second Circuit in *Bellamy v. Federal Home Loan Mortgage Corporation* attempted to dismiss the plain meaning of § 1322(b)(2) by looking around the meaning of the actual words of the prohibitory language itself, and instead analyzing the location of such language in relation to other words and phrases of that subsection. *Bellamy v. Federal Home Loan Mortgage Corporation*, 962 F.2d 176, 180-81 (2d Cir. 1992). This attempt evades the plain issue under § 1322(b)(2), which is whether respondent is a holder of a claim secured only by an interest in the petitioners' residence.[4] Moreover, this is clearly contrary to the teaching of *Dewsnup* that, in a complex statute, one must exercise care not to place excessive emphasis on the location of a phrase with clear meaning, within the structure of a multi-faceted sentence or statutory provision. To do so in this case, as a means to override the plain meaning of the clause protecting home mortgage lenders, would make a mockery of statutory interpretation.

Essentially, petitioners seek to avoid this plain meaning and utilize § 506(a) as an independent cramdown statute, thereby reducing home mortgage loans to the actual value of the residence itself. Contrary to the argument of the petitioners, § 1322(b)(2) protects all claims which are secured only by liens against homes, *not* merely the amount of an allowed secured

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[3] The term "claim" is defined in the definitional provisions at 11 U.S.C. § 101(5), not § 506(a).

[4] *See In re Boullion*, 123 B.R. 549 (Bankr. W.D. Tex. 1990); *Matter of Kaczmarczyk*, 107 B.R. 200 (Bankr. D. Neb. 1989); *In re Russell*, 93 B.R. 703, 705 (D. N.D. 1988).

claim, a term used for other purposes in § 506(a). There is no apparent connection between the language of § 506(a) recognizing the secured and unsecured portions of an allowed claim for the purposes of that section, and the cramdown provision at § 1322(b)(2) that specifically protects from modification the rights of any holder of a claim secured solely by a mortgage on the debtor's residence.

Moreover, the language used in §§ 506(a) and 1322(b)(2) is significantly different. The term "allowed secured claim" is used in § 506(a) while the language "a claim secured only by a [home mortgage]" is used in § 1322(b)(2). Additionally, the different terminology appears in two very different chapters of the Bankruptcy Code, in sections that have entirely different purposes.[5] An attempt to meld these sections together so as to make § 506(a) an independent cramdown provision overriding the plain and simple meaning of the protective language at § 1322(b)(2) requires a leap of faith that is nowhere justified in the language of the statute or the legislative history.

In *Dewsnup v. Timm*, 502 U.S. ___, 112 S.Ct. 773 (1992), this Court rejected efforts of the debtor similarly to meld together unrelated language with different purposes in § 506(a) and (d).[6] The language in §§ 506(a) and 1322(b)(2) is far less similar and is farther removed, both in terms of physical location and appar-

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[5] *See infra*, Part II.

[6] As noted in the *amici* brief (at page 25), "[t]he issue in *Dewsnup* was whether a chapter 7 debtor could use §§ 506(a) and 506(d) to strip down a lien." More specifically, the issue was whether § 506(a) could be used to bifurcate the lien for purposes of cramdown, as opposed to merely establishing the amounts of the secured and unsecured claims for other purposes. The Court responded in *Dewsnup* that § 506(a) does not serve to bifurcate the claim for puposes of cramming down the lien, which survives as an *in rem* interest that flows through a bankruptcy (unless, of course, crammed down pursuant to a specific provision in Chapter 11, 12 or 13). Yet the petitioners in this case are seeking to use § 506(a) in precisely that manner, as a cramdown provision.

ent purpose, as compared to § 506(a) and (d). Furthermore, if petitioners' analysis is correct, the language of § 506(a) is irreconcilable with the plain meaning of § 1322(b)(2), as well it should be. The two subsections have two entirely different purposes, i.e., determining distributions to unsecured claims as opposed to lien modification. The Bankruptcy Code prescribes a different approach for each purpose. Thus, the petitioners' argument in this case is far weaker than that of the debtor in *Dewsnup*.

Application of § 506(a) to modify the lien, where the value of the collateral is less than the debt, would modify the rights of the holder of a claim secured only by a security interest in the principal residence of the debtor, as clearly barred by § 1322.[7] Under § 1322, the only permissible modification of a claim secured by a residential mortgage is the curing of default and the reinstatement of regular installment payments under § 1322(b)(5).[8]

The obvious meaning of § 1322(b)(2) is that claims with no collateral other than mortgages on the debtor's home cannot be modified in a Chapter 13 case. There are evident societal reasons for this treatment. The very lenient terms available to borrowers on home mortgage loans, in comparison to other forms of consumer credit, reflect the societal expectation that

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[7] *See e.g., In re Chavez*, 117 B.R. 733 (Bankr. S.D. Fla. 1990); *In re Boullion*, 123 B.R. 549 (Bankr. W.D. Tex. 1990); *In re Russell*, 93 B.R. 703 (D. N.D. 1988); *In re Catlin*, 81 B.R. 522 (Bankr. D. Minn. 1987); *In re Hynson*, 66 B.R. 246 (Bankr. D. N.J. 1986), rejected by *In re Harris*, 94 B.R. 832 (D. N.J. 1989); *In re Simpkins*, 16 B.R. 956 (Bankr. E.D. Tenn. 1982).

[8] *See e.g., In re Sauber*, 115 B.R. 197 (Bankr. D. Minn. 1990); *Matter of Kaczmarczyk*, 107 B.R. 200 (Bankr. D. Neb. 1989).

mortgages on the debtor's home create a legally safe and secure investment vehicle. The entire mortgage finance system in the United States is built on this premise.[9]

Furthermore, the Chapter 13 cramdown provision[10] offers creditors few of the traditional safeguards built into the equivalent Chapter 11 provision,[11] apparently because the types of consumer credit and collateral most often subject to cramdown under § 1322(b)(2) involve relatively small sums of money and therefore do not warrant expensive and time-consuming proceedings such as those under § 1129. In contrast, mortgage loans on the debtor's home typically represent sizeable, carefully negotiated transactions involving liens on a valuable asset that has the potential to appreciate in value. There is no precedent in either the Bankruptcy Code or the legislative history for allowing the debtor to restructure this kind of security arrangement unilaterally for his or her sole benefit, at the expense of the other contracting parties.

The significant exception to this rationale was *National Life Insurance Co. v. Pinegate Associates, Ltd.*, 2 B.C.D. 1478 (Bankr. N.D. Ga. 1976), where the debtor crammed down a multifamily real estate mortgage loan during a period of depressed property values in order to impose the loss on the secured creditor, while retaining for the debtor the potential for future appreciation in value. This is precisely what the petitioners in this case are seeking to do. The response to *Pinegate* was enactment of 11 U.S.C. § 1111(b), de-

[9] *See generally, In re Hemsing*, 75 B.R. 689 (Bankr. D. Mont. 1987); *In re Hynson*, 66 B.R. 246 (Bankr. D. N.J. 1986) rejected by *In re Harris*, 94 B.R. 832 (D. N.J. 1989).

[10] 11 U.S.C. § 1322(b)(2).

[11] 11 U.S.C. § 1129.

signed to prohibit this outcome in Chapter 11 cases.[12] The petitioners now seek to resurrect *Pinegate* in the context of home mortgage debt under the guise of the statutory language of § 506(a), when § 1322(b)(2) was clearly designed to do just the opposite.

This use of § 506(a) was specifically rejected in *Dewsnup*, when this Court noted that:

> The practical effect of petitioner's arguments is to freeze the creditor's secured interest at the judicially determined valuation. By this approach, the creditor would lose the benefit of any increase in the value of the property by the time of the foreclosure sale. The increase would accrue to the benefit of the debtor, a result some of the parties describe as a "windfall."
>
> We think, however, that the creditor's lien stays with the real property until the foreclosure.

Dewsnup, 112 S.Ct. at 778.

Consequently, § 1322(b)(2) is to be read in accordance with its plain meaning, which precludes modification of home mortgage liens.

B. *Response to Amici*

In their *Amici Curiae* brief in support of the petitioners (hereinafter "the *amici* brief"), *amici* David S. Yen, Gary Klein, Daniel L. Haller and Lawrence Young (hereinafter the *"amici"*) begin with the proposition that the plain language of § 1322(b)(2) indicates

[12] For an explanation of 11 U.S.C. § 1111(b), see Robin E. Phelan and Mark X. Mullin, *How Much is That Doggie In The Window: Valuation Issues in Bankruptcy*, 46 Consumer Fin. L. Q. Rep. 107, 128 (1992).

that it protects only the amount of the secured creditor's lien after cramdown under § 506(a). However, by its terms, § 1322(b)(2) protects "the rights of holders . . . of a claim secured only by" a lien on the debtor's home. As this Court noted in *Johnson v. Home State Bank*, 501 U.S. ___, 111 S.Ct. 2150, 2153-54 (1991), a mortgagee's "rights" include the right to payment of the debt and, upon the discharge of the debtor's personal liability, the right to foreclose on the mortgage.[13] Thus, it would appear that a focus on the rights of the creditor, as opposed to the status of the claim, is clearly present in § 1322(b)(2). Of course, the language preferred by the *amici* would not have been used, because it is not the approach of the Bankruptcy Code to refer to a "creditor secured by a lien." The *amici's* other references to "creditors" in the Bankruptcy Code[14] refer to the claims of creditors, not their liens. Section 1322(b)(2) clearly protects the rights of certain creditors to enforce such liens regardless of how their claims are classified.

The further argument of the *amici* that home mortgages should be subject to cramdown because "[n]othing in § 1322(b)(2) states that § 506(a) does not apply" again requires one to assume that Congress used this subtle omission to change the basic and historic relationship between bankruptcy claims and *in rem* liens, and that the failure of Congress to foresee the very creative arguments in the *amici* brief and to address them specifically in the statute means that the *amici* must be correct. The view of the *amici* would require a very prescient Congress indeed.

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[13] *See also In re Etchin*, 128 B.R. 662, 667 (Bankr. W.D. Wis. 1991) (rights of holders of secured claims "include the right to credit bid with the unsecured portion of the debt at a foreclosure sale or otherwise to avail themselves of benefits from appreciation in the value of the property").

[14] See references cited in the *amici* brief, p. 22.

II. The Basic Structure Of The Bankruptcy Code Is Inconsistent With The Use Of Section 506(a) As A Cramdown Provision

A. The Bankruptcy Cramdown Provisions

The Bankruptcy Code contains three chapters designed to enable the debtor to restructure his or her debts: Chapters 11, 12, and 13. Each of these contains a "cramdown" provision[15] allowing a debtor, without the consent of the secured creditor, to restructure secured debt in a bankruptcy plan by stripping from the lien the amount of debt in excess of the value of the collateral. Otherwise, the lien would flow through bankruptcy unimpaired by the discharge of the debtor's personal liability, under 11 U.S.C. § 524(a)(1). *See e.g., Dewsnup*, 112 S.Ct. at 777-78 (noting and affirming the long-standing rule that "liens pass through bankruptcy unaffected").

Thus, a debtor seeking to cram down secured debt must proceed under § 1129(b), § 1222(b)(2), or § 1322(b)(2). There is no equivalent in Chapter 7 because that chapter is designed to liquidate, and not restructure, the debtor's assets and liabilities. When debtors sought to use Bankruptcy Code § 506(a) as an independent cramdown provision in Chapter 7 cases, this Court properly rejected such a notion. Specifically, this Court in *Dewsnup*, recognized that liens can be restructured only pursuant to a specific cramdown provision in a designated reorganization proceeding, and not by use of general administrative provisions such as § 506(a). *Dewsnup*, 112 S.Ct. at 778-79.

This result is consistent with the basic structure of the Bankruptcy Code. If § 506(a) were an independent cramdown provision, as the petitioners argue, there would be no need for §§ 1129(b), 1222(b)(2), and 1322(b)(2), or indeed for Chapters 11, 12, and 13 at all,

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[15] 11 U.S.C. §§ 1129(b), 1222(b)(2) and 1322(b)(2).

except possibly to escape the effects of *Dewsnup* in Chapter 7.[16] All reorganizations, family farmer arrangements, and individual debtor plans could be structured using only § 506(a). The United States Court of Appeals for the Second Circuit in *Bellamy* essentially takes the position that this is what Congress intended and that the purpose of § 1322(b)(2), and presumably, by analogy, §§ 1129(b) and 1222(b)(2) as well, is simply to protect the creditor against a reduction in the monthly installment payments on the remaining loan balance. *Bellamy*, 962 F.2d at 184-185. This position cannot be supported when viewed in the context of the role of § 506(a), and would trivialize the Bankruptcy Code's elaborate and very specific cramdown provisions.

In *Dewsnup*, this Court correctly recognized that § 506(a) is not a definitional provision for purposes of restructuring secured debt. As noted above, arguments to the contrary would render § 506(a) the preeminent Bankruptcy Code cramdown provision, in derogation of the carefully crafted scheme of Chapters 11, 12, and 13. This would turn on its head the basic principle of statutory construction, that a specific provision, such as § 1322(b)(2), controls over those of a general nature such as § 506(a).[17] Thus, even if § 506(a)

[16] The *amici* argue that bifurcation of home mortgage liens under § 506(a) would operate independently of § 1322(b)(2) and therefore would not violate the § 1322(b)(2) restriction on modification in the plan. *See* the *amici* brief, pps. 37-38. Contrary to this reasoning, it is clear that the bankruptcy court's authority to modify liens in Chapter 13 cases is derived from § 1322(b)(2), which expressly grants that authority, subject to the exception for home mortgage liens. The argument in the *amici* brief, that a § 506(a) cramdown would leave the lien unaffected by the Chapter 13 plan (*see* the *amici* brief, pps. 38-39), illustrates precisely how this view would render as surplusage the procedures in Chapters 11, 12, and 13 that were intended by use of a confirmed plan to be the mechanisms for restructuring secured debts.

[17] *See In re Mitchell*, 125 B.R. 5, 6 (Bankr. D. N.H. 1991); *In re Boullion*, 123 B.R. 549, 550 (Bankr. W. D. Tex. 1990) and cases cited therein; *see also In re Sauber*, 115

were a cramdown provision, which it clearly is not, § 1322(b)(2) would stand as a specific exception to the general rule of § 506(a).

B. Legislative History

The *amici* brief cites extensively from the House Report relating to treatment of liens.[18] This language is mainly general in nature and refers to the basic approach in the Bankruptcy Code of bifurcating undersecured claims for purposes of determining the extent of adequate protection needed and for other such general matters. This general language is not helpful with regard to cramdown of liens, as it discusses the treatment of liens as a general concept and does not relate to specific protective provisions such as §§ 1111(b) and 1322(b)(2).

Nonetheless, the *amici* brief derives from this general language the conclusion that § 506(a) "imports into virtually every aspect of bankruptcy law the economic reality of what a security interest is actually worth."[19] *Dewsnup* specifically rejected the argument that general provisions in Chapter 5 of the Bankruptcy Code necessarily control every issue regardless of the context.

Further language in the *amici* brief, at pages 32-33 (quoting again from the House Report), refers to the effect of § 506(a) in establishing the unsecured claim of an undersecured creditor for purposes of receiving

B.R. 197, 199 (Bankr. D. Minn. 1990) ("The application of general concepts is not universal in the scheme of the [Bankruptcy] Code, but is subject to specific limitation, and even total disregard, in some instances").

[18] *See* the *amici* brief, pps. 27-33, citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 124 (1977).

[19] *See* the *amici* brief, p. 30.

payment with general unsecured creditors. There can be no doubt that this is precisely the purpose of § 506(a), and that this unsecured claim exists quite apart from the undersecured creditor's *in rem* lien rights, which, as noted, flow through bankruptcy subject to the specific cramdown provisions in Chapters 11, 12, and 13.

As the House Report further notes,[20] this was intended to reject prior decisions that gave the undersecured creditor a full secured claim for the total debt as against the distributable assets of the bankruptcy estate "in preference to all unsecured creditors". Thus, the House Report makes clear that § 506(a) relates only to claims against the estate, and does not purport to terminate the *in rem* interest represented by the lien, which, as recognized in *Dewsnup*, continues to flow through bankruptcy. In a Chapter 13 case, this *in rem* interest, the lien, can be terminated only under § 1322(b)(2), subject to the limitation that protects liens on the debtor's residence.

It is true, as noted in Senate Report No. 989,[21] that the Bankruptcy Code refers, for the most part, to claims and not creditors, though this in no way supports the *amici* argument that § 506(a) is the primary Bankruptcy Code cramdown provision. The language at § 1322(b)(2) is quite clear in protecting any "claim" secured solely by a lien on the debtor's residence, and other language in § 1322(b)(2) focuses on protecting the "rights" of the "holder" of such a claim. Thus the pertinent language in § 1322(b)(2) makes clear that its protection is not limited to a narrow definition of "secured claim," even if that term was defined elsewhere for purposes of cramdown.

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[20] *See* the *amici* brief, p. 33.

[21] *See* the *amici* brief, p. 41, citing S. Rep. No. 989, 95th Cong. 2d. Sess. 68 (1978).

C. The Potential Impact of *Dewsnup* in Chapter 11 Cases

(i) *General Impact*

It has been argued that the *Dewsnup* view of § 506 should be limited to Chapter 7 cases, because of the additional problems that this rationale would cause in Chapter 11 cases.[22] While the case at bar arises under Chapter 13, an analysis of this argument is relevant to a determination of the proper relationship between § 1322(b)(2) and § 506(a). A careful analysis of this issue reveals that such arguments are based on an incorrect interpretation of both *Dewsnup* and Chapter 11.

The argument that applying *Dewsnup* in Chapter 11 cases would upset the treatment of subordinate liens that are subject to prior liens exceeding the value of the collateral is based on false assumptions. *Dewsnup* does not distinguish between liens that are covered by valuable collateral and those that are not. A lien simply flows through Chapter 7 regardless of the value of the collateral. The amici brief contends that this interpretation would allow a junior lienor to disrupt agreements between the debtor and a prior lienor designed to allow the debtor to retain the property by continuing to make payments to the prior lienor. However, this contention simply reflects the inherent character of any junior lien, in or out of bankruptcy: such lienor is entitled to assert its legal rights until the lien is extinguished by foreclosure or is treated in a confirmed bankruptcy plan.

In a Chapter 11 case, the subordinate lienor is allowed to participate as an unsecured creditor in confirmation of the plan pursuant to § 1129(a) or pursuant to cramdown under § 1129(b), while retaining the lien subject to § 1129(b)(2)(A)(i)(I). The result is

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[22] *See e.g.*, Margaret Howard, *Dewsnupping the Bankruptcy Code*, 1 J. Bankr. L. and Prac. 513, 517-18 (1992).

similar in Chapter 13. The argument that subordinate liens should be stripped away under § 506(a), merely because of the possibility that a subordinate lienor may have an improved bargaining position as compared to unsecured creditors, represents an extraordinary approach to bankruptcy, in which fundamental, negotiated rights are suddenly deemed to be terminated because of the possibility that a creditor might benefit as a result of those rights.[23]

The very weaknesses of the arguments seeking to impair the viability of *Dewsnup* outside of Chapter 7, by considering its implications for Chapter 11 cases, actually suggest that the *Dewsnup* rationale is appropriate in Chapter 11 and 13 cases.

(ii) Impact of § 1111(b)

The *amici* specifically argue that Congress created an express limitation on cramdowns in Chapter 11 cases, at § 1111(b),[24] and therefore could have done the same for holders of residential mortgages in Chapter 13 if that was intended.[25] The simple answer is that Congress did exactly that in § 1322(b)(2).

The more extensive language of § 1111(b) is required because Chapter 11 contains much more elaborate secured creditor protections and calls for greater creditor participation in confirmation of the

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[23] Moreover, in such cases the subordinate lienor has no incentive to interfere with a continuation of payments to the prior lienor. Indeed, the subordinate lienor is benefited to the extent the prior lien is reduced, and normally can be expected to encourage rather than discourage such arrangements.

[24] As noted *supra* at Part I, Congress enacted § 1111(b) in response to *National Life Insurance Co. v. Pinegate Associates, Ltd.*, 2 B.C.D. 1478 (Bankr. N.D. Ga. 1976), where the court allowed the debtors to do essentially the same thing that the petitioners in this case are seeking. Congress clearly perceived this as an abuse, and § 1111(b) was enacted to reject *Pinegate*. Language to the same effect was included in § 1322(b)(2) for the same apparent purpose.

[25] *See amici* brief, pps. 22-24.

plan, than does Chapter 13. In Chapter 13, the unsecured claim is important only for participating in distributions under the plan. Recognizing that an undersecured home mortgage lender's lien will flow through bankruptcy unmodified under § 1322(b)(2), the only remaining issue is the extent to which the unsecured claim is entitled to payment under §§ 506(a), 1322(a), and 1325(b). There is no need to mention payments under the plan in § 1322(b)(2), which deals with a different issue, the *in rem* lien.

In contrast, Chapter 11 contemplates extensive creditor involvement in formulation and confirmation of the plan, based in part on the amount of unsecured claims.[26] These provisions enable the debtor to modify a secured claim, but only upon meeting certain requirements.[27] Section 1111(b) permits the secured creditor to achieve immunity to such modification or cramdown, if, in turn, the creditor is willing to relinquish its unsecured claim under § 506(a) and forego its participation in confirmation of the plan. This allows the undersecured creditor to opt out of the plan, despite § 506(a), which is the reason for inclusion in § 1111(b) of the reference to § 506(a).

In effect, Chapter 11 gives the undersecured creditor the option either to retain the unsecured claim recognized at § 506(a) for purposes of participating in confirmation of the plan and risk a cramdown of the lien under § 1129(b), or relinquish the unsecured claim and its attendant voting rights under Chapter 11 and rely solely on the lien, which thereby is given immunity from cramdown.

In contrast, the undersecured creditors in Chapter 13 have no voting rights and do not significantly participate in formulating or confirming the plan of reor-

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[26] *See e.g.*, 11 U.S.C. §§ 1102, 1103, 1126, 1129.

[27] *See e.g.*, 11 U.S.C. § 1129(b).

ganization. Thus, there are no such rights to relinquish, and no need to refer to § 506(a). Furthermore, the immunity from cramdown at § 1322(b)(2) is limited to a single class of claims and is automatic. All of this reflects the highly simplified nature of Chapter 13 in comparison to Chapter 11, as befits the purpose of each. The home mortgage lender is protected by § 1322(b)(2) because of the nature and societal importance of home mortgage credit, which extends beyond the new home purchase to home improvement and construction loans.

D. Impact of *Dewsnup* in Chapter 13 Cases

Several additional *Dewsnup* "problems" have been asserted in the specific context of Chapter 13 cases. One is the argument that precluding cramdown under § 506(a) will mean that Chapter 13 debtors will only be able to cram down secured debt within the limitations of the specific Chapter 13 cramdown provision at § 1322(b)(2). This, of course, is only a "problem" if one is dissatisfied with the statutory language at § 1322(b)(2) and is seeking to override its limitations by judicially creating a new cramdown provision at § 506(a).

Another argument is that this recognition of the true meaning of § 1322(b)(2) somehow prevents a debtor from saving his or her home. This argument fails for three reasons. First, § 1322(b)(2) does not prevent the debtor from curing any default so as to stop an impending foreclosure,[28] and the automatic stays at § 362 and § 1301 provide extra breathing room to enable a debtor to effectuate this cure. These are the true keys to saving a debtor's home in Chapter 13, not § 1322(b)(2).

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[28] *See* 11 U.S.C. § 1322(b)(5).

Second, those courts that have allowed cramdown of home mortgage debt under § 506(a) in Chapter 13 cases typically have concluded that the residual effect of § 1322(b)(2) is to preclude reduction of the debtor's monthly installment payments.[29] As a result, the benefit to the debtor comes at the end of the loan term, long after the bankruptcy and, presumably, long after the debtor's financial exigency has ended, when the loan balance is prematurely paid in full. This long-term, deferred benefit is clearly not relevant to the debtor's need to "save his home" during the bankruptcy proceeding, and hence recognizing the § 1322(b)(2) limitation on home mortgage cramdowns does not impair homeownership.

Third, it is clear and unmistakable from the statutory language that Congress, surely cognizant of the points noted above, singled out residential liens for special protection from cramdown under § 1322(b)(2). If this special protection represents a "problem" for homeowners who would like to restructure their mortgage loans unilaterally every time there is a dip in the housing market, they should make this case to Congress instead of reinterpreting the Bankruptcy Code to find a new cramdown provision where none was intended.

Another alleged Chapter 13 *Dewsnup* "problem" is said to arise under Bankruptcy Code § 1325(a)(5)(B), which requires the debtor to pay the holder of an allowed secured claim the present value of that claim. Use of the language, "allowed secured claim," in

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[29] *See, e.g., Bellamy v. Federal Home Loan Mortgage Corporation*, 962 F.2d 176, 184 (2d Cir. 1992) (finding that "the terms of payment" must remain unchanged); *In re Brouse*, 110 B.R. 539, 544 n.7 (Bankr. D. Colo. 1990) (explaining that "the debtor is obligated to continue to pay the contract interest rate"); and *In re Demöff*, 109 B.R. 902, 916 (Bankr. N.D. Ind. 1989) (determining that debtors are only prevented "from changing the payment terms of claims").

§ 1325(a)(5) suggests a bifurcation of the claim, so that any plan modifying a secured claim under § 1322(b)(2) must also meet the test of § 1325(a)(5)(B) by preserving in the plan the time-value of the secured claim after cramdown. In this respect, § 1325(a)(5)(B) is the Chapter 13 equivalent of § 1129(b)(2)(A)(i)(I). Like the latter provision, § 1325(a)(5)(B) does not directly regulate the amount of the secured claim. After a cramdown is effected pursuant to § 1322(b)(2), the plan must preserve the present value of the crammed down lien over the life of the plan. In effect, this requires the payment of interest on the amount of the claim. Of course, a claim secured solely by a lien on the debtor's residence would not be subject to modification under § 1322(b)(2), and hence would involve no problems under § 1325(a)(5)(B).

Dewsnup's recognition of the lienor's *in rem* rights confirms that such liens flow through bankruptcy, unless modified pursuant to a Chapter 11, 12, or 13 plan, including a possible cramdown under §§ 1129(b), 1222(b)(2) or 1322(b)(2), in which case the lien flows through *as modified* and as additionally protected by §§ 1129(b)(2)(A)(i), 1225(a)(5)(B), or 1325(a)(5)(B). Nowhere in the statutory language is there anything to indicate that § 506(a) supersedes the § 524(a)(1) exclusion of liens from the effect of the bankruptcy discharge, outside the specific cramdown provisions cited above. Consequently, unless the lien is modified or restricted in a plan, the ultimate value of the lien will depend on the value of the property and may fluctuate as the property value changes over time. This is a fundamental characteristic of any *in rem* interest. *Dewsnup* again confirms this, noting that a lien stays with the property "until the foreclosure" and that this allows the creditor to benefit from any appreciation in value "during bankruptcy." *Dewsnup*, 112 S. Ct. at 778.

III. The Post-*Dewsnup* Case Law

A. The *Bellamy* Case Overlooks the Reasoning in *Dewsnup*

The first United States Court of Appeals case to consider Chapter 13 cramdowns after *Dewsnup* was *Bellamy v. Federal Home Loan Mortgage Corporation*, 962 F.2d 176 (2d Cir. 1992). In *Bellamy*, the bankruptcy court confirmed a plan modifying the home mortgage lien, and the district court affirmed. *In re Bellamy*, 122 B.R. 856 (Bankr. D. Conn. 1991), aff'd 132 B.R. 810 (D. Conn. 1991). On appeal to the United States Court of Appeals for the Second Circuit, the creditor argued that *Dewsnup* precludes the use of § 506(a) to cram down liens and that § 1322(b)(2) precludes modification of home mortgage liens in Chapter 13 cases.

The Second Circuit attempted to distinguish away the *Dewsnup* reasoning in this context, concluding that the mortgage lien protected by § 1322(b)(2) is only the secured portion of an undersecured claim as defined in § 506(a). In this way, the home mortgage lien could be crammed down under § 506(a) before the protective language at § 1322(b)(2), prohibiting modification of a home mortgage lien, takes effect. In the *Bellamy* view, the remaining effect of § 1322(b)(2) is to prohibit modification of the payment schedule as to the loan balance remaining after cramdown, so that the debtor must pay the full loan payments under the Chapter 13 plan, but receives a windfall in the distant future when the loan is paid off early. The *Bellamy* court specifically rejected the creditor's argument that § 1322(b)(2) protects home mortgage liens from modification.

The *Bellamy* court's conclusion that cramdown under § 506(a) does not constitute modification of the home mortgage lien because § 1322(b)(2) does not specifically refer to and override § 506(a), overlooks the basic role of § 506(a) as explained in *Dewsnup*.

Although *Dewsnup* did not specifically address the issue of home mortgage cramdowns in Chapter 13 cases, as that was not the issue before this Court, the reasoning in *Dewsnup* is clearly hostile to the use of § 506(a) to preempt the specific cramdown provisions of the Bankruptcy Code. The effort of the Second Circuit in *Bellamy* to meld §§ 506(a) and 1322(b)(2) together as part of a consistent statutory plan to allow cramdown of home mortgage debt under § 506(a), but not allow a reduction in the mortgage payments under § 1322(b)(2), is creative but indefensible in view of *Dewsnup*.[30]

B. Other Decisions Following *Bellamy*

In *Sapos v. Provident Institution of Savings in the Town of Boston*, 967 F.2d 918 (3d Cir. 1992), the United States Court of Appeals for the Third Circuit concluded that the *Dewsnup* rationale does not preclude cramdown of home mortgage liens in Chapter 13 cases. The *Sapos* decision is essentially a restatement of the Third Circuit's prior holdings before *Dewsnup*. Like *Bellamy*, *Sapos* ignores *Dewsnup's* rejection of the use of § 506(a) as a definitional or cramdown provision. As a result, *Bellamy* and *Sapos* are of no assistance in analyzing the impact of *Dewsnup* in Chapter 13 cases.

Similarly, in *Lomas Mortgage, USA v. Wiese*, 980 F.2d 1279 (9th Cir. 1992), the United States Court of Appeals for the Ninth Circuit dismissed *Dewsnup* as irrelevant to the use of § 506(a) in Chapter 13 cases, thereby ignoring the important lessons of *Dewsnup* in any lien-stripping case. Ironically, though perhaps not surprising, *Lomas* reaffirmed and relied on the prior

[30] The result is an interpretation that does not provide the debtor with relief from the obligation to make full payments during the course of the bankruptcy plan when the relief probably is most needed. This interpretation, however, does provide the debtor with a windfall in the form of a premature payoff of the reduced loan balance at a distant time in the future when the debtor may well be more affluent and the property may have increased considerably in value.

Ninth Circuit decision in *In re Hougland*, 886 F.2d 1182 (9th Cir. 1989), which emphasized the bifurcation of claims under § 506(a). As noted above, however, that is not the issue here. The issue in this case is whether § 506(a) can be used to effect the modification of liens as *in rem* interests that otherwise flow through bankruptcy unaffected by the estate, bankruptcy claims, or the § 524(a) discharge.

Clearly, § 506(a) can be used to bifurcate claims into secured and unsecured portions for such purposes as participation in distributions of the estate to holders of unsecured claims. The language of *Hougland* and *Lomas* is consistent with accepted bankruptcy law on this point. It is quite another thing, however, to conclude that this converts § 506(a) into a master cramdown provision allowing modification of *in rem* interests that traditionally have flowed through bankruptcy.

Contrary to these cases, the legal and policy issues implicated by *Dewsnup* in the context of Chapter 11, 12, and 13 cases do not allow the use of § 506(a) to cram down secured debt prior to application of § 1322(b)(2). *Dewsnup* handled the tough question in a Chapter 7 case, where there is no specific cramdown provision to supplant, by concluding that § 506 cannot be used for this purpose. It seems even clearer that § 506 should not be used to supersede the comprehensive cramdown procedures in Chapters 11, 12, and 13. The courts in *Bellamy* and *Sapos* struggled with the clear implications of this, by concluding that § 1322(b)(2), which was obviously intended to prohibit cramdown of home mortgage liens,[31] instead allows it under § 506(a). Their struggle ignores and obscures other issues relating to statutory interpretation and the basic structure of the

[31] *See In re Chavez*, 117 B.R. 733, 736 (Bankr. S.D. Fla. 1990); *Matter of Kaczmarczyk*, 107 B.R. 200, 203 (Bankr. D. Neb. 1989).

Bankruptcy Code that should be more clear in the aftermath of *Dewsnup*. Not every court has been so preoccupied with resistance to *Dewsnup* to the detriment of other issues, however, as evidenced in the discussion below.

C. *In re Dyer* and the Proper Application of Section 506(a) in Chapter 13 Cases

Cases such as *In re Dyer*, 142 B.R. 364 (Bankr. D. Ariz. 1992), have had no difficulty following the *Dewsnup* reasoning in Chapter 13 cases to prohibit cramdown of home mortgage liens under §§ 506(a) and 1322(b)(2). The *Dyer* court reasoned that in Chapter 13 cases, § 506(a) is properly used only to determine secured or unsecured status for purposes of receiving payment under the Chapter 13 plan, and not to modify liens securing debts. In effect, § 506(a) bifurcation relates only to the debtor's personal liability and the creditor's claim against the estate, and does not affect any mortgage as an *in rem* lien. The sole basis for modifying liens in Chapter 13 cases is § 1322(b)(2), and home mortgage liens are exempted. As a result, a lien on the debtor's home can be extinguished only by payment, release, or mortgage foreclosure. The *Dyer* court noted that the *Dewsnup* opinion followed the holding in *Johnson v. Home State Bank*, 111 S. Ct. 2150 (1991), reconfirming that under § 524(a) only the debtor's personal liability is extinguished and liens flow through bankruptcy unless specifically modified, as under § 1322(b)(2).

The *Dyer* court pointed out that bifurcation of undersecured debt into secured and unsecured claims under § 506(a) does not alter the *in rem* nature of a mortgage lien. The *Dyer* court viewed this as being initially consistent with *Hougland*, which relied on § 506(a) to bifurcate the creditor's bankruptcy claim into secured and unsecured parts. However, *Dyer* then pointed out that bifurcation of the claim under § 506(a) should not affect retention of the creditor's lien

against the property, which flows through bankruptcy unless modified under § 506(d) or in Chapters 11, 12, or 13. Modification of the lien in Chapter 13 can only be accomplished through the specific cramdown provision at § 1322(b)(2), subject to the limitations of that provision. The *Dyer* court properly rejected the *Bellamy* rationale as being contrary to both *Johnson* and *Dewsnup*.

IV. Practical Implications of the Petitioners' Position

A. The Foreclosure Argument

The petitioners argue that allowing cramdown of home mortgage debt under § 506(a) in Chapter 13 cases would merely replicate the effect of a foreclosure, since a foreclosure would typically leave the lender holding property with the same value as the amount of the "crammed down" lien under § 506(a).[32] However, this reasoning is demonstrably incorrect.

When debtors abandon property to foreclosure, the secured creditors have the opportunity to purchase the collateral at the foreclosure sale at the current market price. Since such abandonments typically occur during periods of depressed real estate values, this permits creditors to realize any subsequent appreciation in the value of the collateral. Relinquishing this potential for appreciation has always been considered the price a debtor must pay for defaulting on the mortgage obligation in bankruptcy and, at the same time, a benefit that potentially mitigates the loss of the aggrieved lender. This has been an important part of the bargain for mortgage lenders since the beginning of federal bankruptcy law in the 19th century.

The prospect of foreclosure creates an important incentive against default on home mortgage loans

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[32] *See* the petitioners' brief, pps. 5-9.

which is a major factor in the relatively low default rate on loans secured by a debtor's home. This historical record in turn is responsible for the relatively low interest rates charged on consumer loans secured by the debtor's home. If debtors are instead allowed to reduce their home mortgage liens in Chapter 13 every time there is a dip in the market, the mortgage loan bargain will be rewritten into a very one-sided risk. If prices go up, the borrower wins. If prices go down, the lender takes the loss, while the borrower retains any subsequent upside potential. Imposition of such a result on mortgage lenders, in derogation of the contract terms and historical relationship between the parties, will inevitably result in an adjustment in future mortgage interest rates in order to compensate for this risk.

Lenders always have assumed some downside risk in such transactions. However, in the past there was consolation in knowing that a borrower who wanted to discharge home mortgage debt in bankruptcy would have to relinquish his or her home in the process, thereby yielding any subsequent appreciation in value. This has been an important constraint on abuse of the system, and an important consideration for mortgage lenders, as most borrowers traditionally have been hesitant to "walk away" from this important asset. If this constraint is to be removed, it will have immense consequences for all mortgage markets.

The enactment of the new Chapter 13 in 1978 represented a major change in the relationship between consumer debtors and secured parties, permitting consumer debtors to restructure debts as businesses do in Chapter 11, but without many of the creditor safeguards built into Chapter 11.[33] Section 1322(b)(2) was intended to protect home mortgage fi-

[33] *See In re Etchin*, 128 B.R. 662, 666 (Bankr. W.D. Wis. 1991).

nance from the dangers presented by this change.[34] The petitioners now seek to overturn this legislative and economic balance judicially. The revisionist use of § 506(a) to override the plain meaning of § 1322(b)(2) would deprive home mortgage lenders of any hope for recovery in a depressed real estate market. The practical result would be that only those with a very high net worth or surplus "disposable income," which can be accessed by creditors in Chapter 13 pursuant to Bankruptcy Code § 1325(b), or those able to make a huge downpayment would likely be deemed creditworthy for purposes of mortgage lending, since the collateral alone would no longer serve as a primary basis for the loan.

B. The *Amici* Argument

Apparently, in the *amici* view, § 506(a) would operate as the supreme cramdown provision in Chapters 11, 12, and 13, superseding the carefully crafted and more specific cramdown provisions in the reorganization chapters, while having no such effect in Chapter 7, the only chapter without its own comprehensive cramdown provision. This interpretation creates a fundamental conflict that strikes at the heart of the Bankruptcy Code reorganization structure and would convert Chapters 11, 12, and 13 into little more than a means of evading the *Dewsnup* limitations on the use of § 506(a) in Chapter 7 cases. The extensive cramdown provisions in Chapters 11, 12 and 13 would become merely a footnote to the real cramdown provision at § 506(a).

The examples used in the *amici* brief to illustrate the effect on subordinate mortgages of such a revision of the Bankruptcy Code's well crafted cramdown provisions mischaracterize the status of such mortgages in and out of bankruptcy. For instance, the example at

[34] *See id.*

pages 30-31 characterizes a third mortgage holder as "a completely unsecured creditor" because the value of the collateral is less than the balances owing on the two prior mortgages. The *amici* brief then concludes that wiping out the *in rem* lien of this third mortgage under § 506(a) would not impair the "economic reality" of the claim. However, this ignores the leverage provided by this lien, which must be paid before the homeowner will have clear title. As noted above, the holder of this subordinate mortgage may expect improvement in its position as a result of inflation in housing prices or payments on the prior loans. This is "economic reality." Indeed the *amici* brief makes very clear that impairment of this economic reality is precisely the purpose of the arguments asserted in that brief.[35] The *amici* conclude that "no unfairness" will result from depriving the creditor of this bargained for status, because the debtor will get a fresh start "free of [this] unjustified leverage."

The subordinate mortgage lien is not unfair and the resulting leverage is not unjustified. In any case, fairness and unjustified leverage are not bases for depriving a creditor of *in rem* lien rights in bankruptcy. The *amici* brief is, moreover, quite inconsistent on this point, arguing in one phrase that the leverage and potential value of a subordinate lien are "economically valueless," while in the same sentence arguing that release from this burden is essential to the debtor's fresh start.[36] Obviously, the resulting leverage has some value to the creditor or the debtor would not be so eager to eliminate it. It should also be obvious that this subordinate home mortgage was bargained for and agreed to by the debtor, typically in return for cash or other valuable consideration. It may

[35] *See* the *amici* brief, pps. 1-9 and 30-33.

[36] *See* the *amici* brief, p. 32.

be that the *amici* would like to see undersecured residential mortgage liens terminated on a *per se* basis in bankruptcy, but there is currently no such provision in the Code and the social judgments involved are clearly the province of the legislature, not the judiciary.

C. The Bankruptcy Discharge Argument

Despite arguments to the contrary,[37] giving effect to the home mortgage protections of § 1322(b)(2) will not allow creditors to circumvent the bankruptcy discharge. The bankruptcy discharge at § 524(a), by its terms, affects only the personal liability of the debtor. Such discharge precludes the home mortgage lien creditor from seeking recourse against the debtor or any property except that subject to the lien. The home mortgage lien creditor is entitled to share pro-rata in the distribution of the estate, pursuant to its unsecured claim as determined under § 506(a), and then is left with the lien on the real property, whatever its value. The possibility of an increase in property values or an improvement of position due to payments on prior liens provide real hope for a future recovery.

Contrary to the argument of the *amici*, this does not "allow the creditor to demand full payment with interest, even if the mortgage was, in real economic terms, totally worthless, despite the discharge."[38] Discharge of the debtor's personal liability precludes any demand for payment, unless the debtor wants the lien released. While the lien provides the lender some leverage and is therefore not "totally worthless", the debtor also has considerable leverage. The debtor's personal liability having been discharged, he or she can walk away from the property and leave it to foreclosure by the prior lienholder, thus extinguishing

[37] *See* the *amici* brief, pps. 33-39.

[38] *See* the *amici* brief, p. 34.

the subordinate lien. This delicate balance is a direct result of the bargain negotiated between the parties. The rights of the lien creditor, as one party to this bargain, should not be arbitrarily eliminated absent compelling evidence that Congress has intended to alter this relationship by expanding the bankruptcy discharge to cover *in rem* as well as *in personam* interests.

CONCLUSION

For the reasons set forth above, the decision of the court below should be affirmed.

Respectfully submitted,

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